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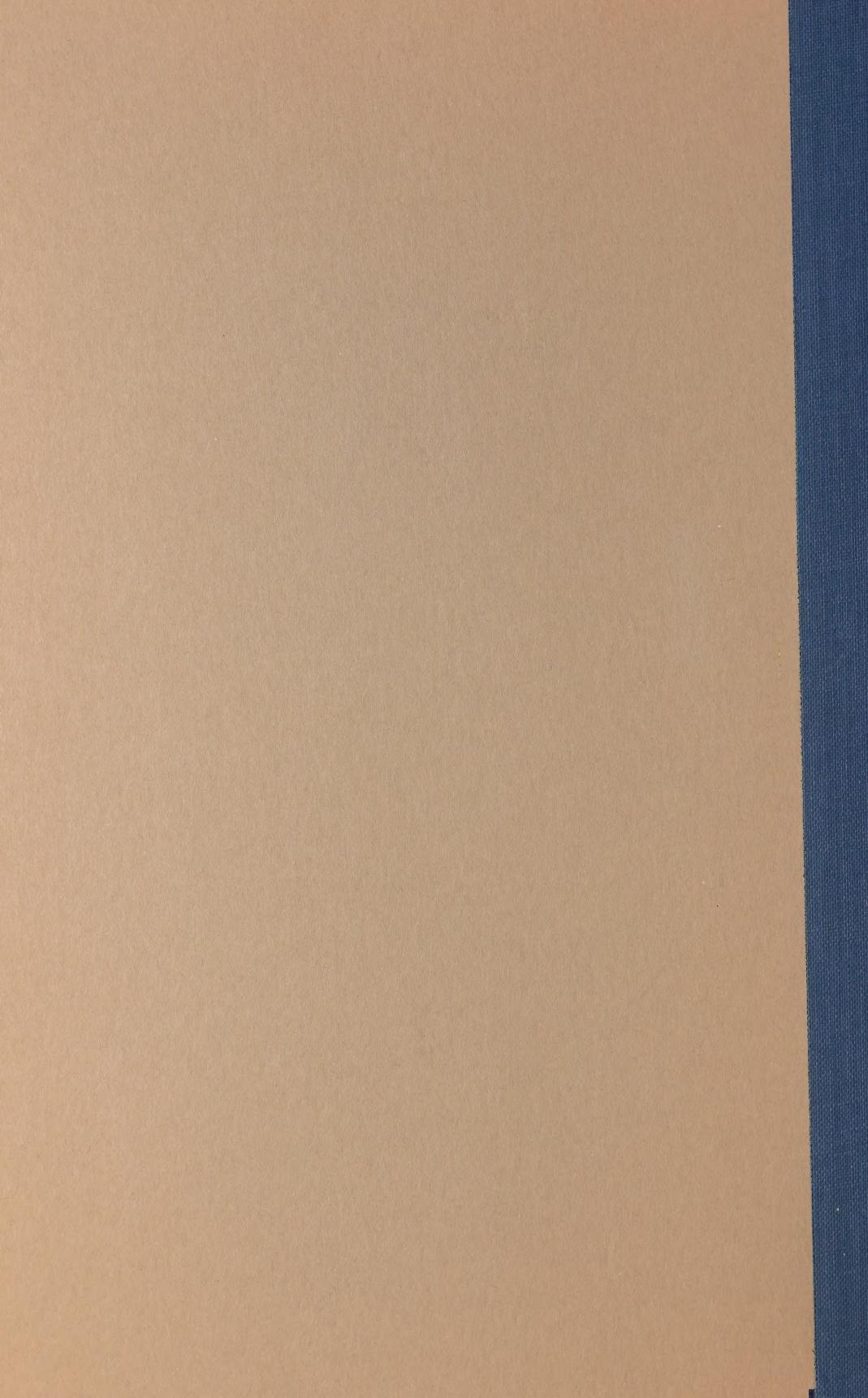
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RESTRICTIVE TRADE PRACTICES COMMISSION

REPORT

Concerning the Acquisition of the Common Shares
of Hendershot Paper Products Limited by
Canadian International Paper Company

∞

DEPARTMENT OF JUSTICE
OTTAWA

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RESTRICTIVE TRADE PRACTICES COMMISSION

REPORT

CONCERNING THE ACQUISITION OF THE
COMMON SHARES OF HENDERSHOT
PAPER PRODUCTS LIMITED BY
CANADIAN INTERNATIONAL
PAPER COMPANY

COMBINES INVESTIGATION ACT

Ottawa
1962

RESTRICTIVE TRADE PRACTICES COMMISSION

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Chairman

Pierre Carignan, Q.C., M.A., LL.L.
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RESTRICTIVE TRADE PRACTICES COMMISSION

OTTAWA

August 2, 1962

Honourable E. Davie Fulton, P.C., Q.C., M.P.,
Minister of Justice,
Ottawa.

Dear Sir:

I have the honour to submit to you herewith the report of the Restrictive Trade Practices Commission in an inquiry relating to the acquisition of the common shares of Hendershot Paper Products Limited by Canadian International Paper Company.

The matter was brought before the Commission by the submission of a statement of the evidence obtained in the inquiry by the Director of Investigation and Research under the Combines Investigation Act and has been dealt with in accordance with the provisions of sections 18 and 19 of the Act.

Argument in regard to the Statement of Evidence was heard by the Commission on November 28, 1960. At the hearing Messrs. F. C. Gascoigne, F. N. MacLeod and D. A. Rankin appeared for the Director of Investigation and Research and Messrs. John J. Robinette, Q. C., Hazen Hansard, Q. C. and A. J. MacIntosh, Q.C. appeared for Canadian International Paper Company and Hendershot Paper Products Limited.

Yours faithfully,

(sgd.) C. Rhodes Smith

C. Rhodes Smith
Chairman

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CHAPTER I

INTRODUCTION

1. Reference to the Commission

This inquiry came before the Commission pursuant to section 18 (1) of the Combines Investigation Act, R. S. C. 1952, Chapter 314, as amended by Chapter 51 of the Statutes of Canada, 1953-54, which prior to the amendment by S. C. 1960, Chapter 45, read as follows:

- "18. (1) At any stage of an inquiry,
- (a) the Director may, if he is of the opinion that the evidence obtained discloses a situation contrary to section 32 or 34 of this Act, or section 411 or 412 of the Criminal Code, and
 - (b) the Director shall, if so required by the Minister, prepare a statement of the evidence obtained in the inquiry which shall be submitted to the Commission and to each person against whom an allegation is made therein."

The inquiry came before the Commission when the Director of Investigation and Research under the Combines Investigation Act submitted a Statement of Evidence dated April 4, 1960 to the Commission and also to the Canadian International Paper Company, the party against whom allegations were made therein with respect to the company's acquisition of Hendershot Paper Products Limited, a manufacturer of shipping containers in Ontario.

Canadian International Paper Company is sometimes referred to herein as C. I. P., and Hendershot Paper Products Limited as Hendershot.

The submission by the Director of a Statement of Evidence with respect to the acquisition of Hendershot by C. I. P. in

1959-60 followed the submission of a Statement of Evidence, dated December 31, 1959 in an investigation entitled "An Inquiry Relating to the Manufacture, Distribution and Sale of Paperboard Shipping Containers and Related Products". (In the present inquiry the Statement of Evidence, dated December 31, 1959 is referred to as the "Shipping Containers Statement"). The earlier inquiry was broad in scope and dealt with developments in the industry up to 1959, including a series of acquisitions which had been made up to that time. It forms a background to the present inquiry and the Director has relied upon evidence obtained in the broader inquiry to support the allegations made as a result of the present inquiry. The inquiry into the manufacture, distribution and sale of paperboard shipping containers is reported upon separately by the Commission. In that report the Commission deals in a comprehensive way with conditions and practices in the industry which are shown by the evidence and analyses the economic effects of the acquisitions of shipping container companies which had been made in various regions across Canada. The analysis and appraisal made by the Commission in its report on the manufacture, distribution and sale of paperboard shipping containers are relevant in a number of aspects to the present inquiry and in view of the fact that such analysis and appraisal are available in that report it is unnecessary to go over the same ground in the present report, and it will be sufficient to refer to matters dealt with in the broader report.

2. Allegations

The Statement of Evidence contains the following allegations:

" . . .

4. It is alleged that the acquisition, by C. I. P. of the common shares of HENDERSHOT, as hereinafter described, is a 'merger, trust or monopoly' within the meaning of the Combines Investigation Act; that the said merger, trust or monopoly has operated and is likely to operate to the detriment or against the interest of the public, thereby constituting a 'combine' within the meaning of the said Act; and that C. I. P. is a party to such combine.

5. The general public detriment to which the merger gives rise is as described in paragraph 362 of Volume IV of the Shipping Containers Statement. In addition the

merger gives rise to particular detriment as follows:

- a) The elimination of HENDERSHOT as a non-integrated producer of shipping containers has the effect of strengthening the combine alleged in paragraphs 5 and 6 of Volume I of the Shipping Containers Statement. HENDERSHOT, while adhering to the alleged combine, has made a practice of selling the larger proportion of its total annual output to certain customers at prices, terms and conditions of sale more favourable to such customers than those agreed upon by the members of the alleged combine for purchasers in general; and
- b) The price paid by C. I. P. for the shares of HENDERSHOT was greatly in excess of the market price of these shares immediately before the acquisition. It was also greatly in excess of the value of the equity in the assets of HENDERSHOT represented by these shares. Accordingly, the transaction saddled the combined enterprise with unduly high overhead costs which in the final analysis have to be borne by its customers and the general public.

6. In respect of the allegation in paragraph 5 (a), the evidence is to be found in the text of the Shipping Containers Statement. The evidence bearing on the allegation in paragraph 5 (b) is set out below."

(Statement of Evidence, pp.1-2)

Paragraph 362 of Volume IV of the Statement of Evidence in the shipping containers inquiry reads in part as follows:

"362. Between 1945 and 1959, inclusive, various companies acquired control over or an interest in the whole or part of the business of another company, as listed in paragraph 7. These mergers must be regarded, not merely individually or in isolation, but in the light of the industry arrangements and practices described in this Statement as existing from the 1930's to 1959 inclusive. It is, in considerable measure, because of such continuing arrangements and practices that the effects of the mergers have been, and will continue, detrimental. (Conversely, the arrangements and

practices must be regarded, not only standing alone, but also in the light of the integrations, by way of mergers, which have taken place in the industry). The detriment to the public common to all these mergers, except the acquisition of Canadian Western Box (Alberta) Limited by MARTIN PAPER, derives from the fact that in each case a shipping container manufacturer, formerly independent of the board mills in ownership and management, has been acquired by a board mill and has become part of its integrated operations. The competition arising from the divergent interests of the two branches of the industry, which in the absence of an agreement such as alleged in paragraphs 5 and 6 would safeguard the interests of users of shipping containers and of the general consuming public, has been pro tanto foreclosed. The process of integration has already proceeded to the extent that only a very small segment of the shipping container industry remains independent of the board mills. In consequence, even after the elimination of the agreement alleged in paragraphs 5 and 6, the possibility of future competition is impaired because:

- (a) New entries into the industry of containerboard manufacturing will be discouraged by the fact that existing outlets for the sale of board have nearly all been absorbed by the present board manufacturers.
- (b) The most likely importers of containerboard have been brought under the ownership and control of the containerboard manufacturers. The restraining influence of actual or potential competition from abroad is thereby curtailed.
- (c) The most significant purchasers of containerboard have been brought under the ownership and control of the containerboard manufacturers and will not shop around among such manufacturers for their requirements.
- (d) New entries into the industry of converting containerboard into boxes will be discouraged by the fact that all or most of the significant existing converters are integrated with containerboard manufacturers thus putting new entrants in danger of a 'squeeze' between containerboard costs and box prices.
- (e) The bulk of the business is now largely concentrated in a few integrated producers, all having a record of anti-competitive behaviour in this industry, and

most of them in another sector of the pulp and paper industry. Two companies, BATHURST and ST. LAWRENCE, on the basis of 1958 figures, now account for approximately 60 per cent by volume of the total shipments of containers in Eastern Canada and are also important producers in the Prairies. Recent figures for containerboard are not in evidence, but the same two companies remain the leaders in the production of containerboard. Their combined market shipments, however, are a smaller proportion than would be indicated by the 1954 figures when they, together with HINDE & DAUCH, now wholly-owned by ST. LAWRENCE, supplied 77 per cent of the total domestic shipments made in Canada as a whole. Under the market structure brought about by the mergers, anti-competitive behaviour does not require forms of organization and methods of consultation which are readily capable of detection and correction.

The detriment in respect of the excepted merger lies in the elimination of competition, without any compensating advantages to the public, which it entailed. In addition to the general detriment referred to above, the various mergers gave rise to particular detriment as follows:

...."

(Statement of Evidence, Paperboard
Shipping Containers and Related
Products, Vol. IV, pp.901-02)

In the remainder of paragraph 362 there are allegations of particular detriment with respect to acquisitions by various companies but it is not considered necessary to set out the further allegations here.

Paragraphs 5 and 6 of Volume I of the Statement of Evidence in the shipping containers inquiry referred to in paragraph 5(a) of the Statement of Evidence quoted earlier are as follows:

"5. It is alleged that, during the period commencing in 1947 and continuing into 1959, the corporations and individual named in paragraph 8, at all relevant times mentioned in paragraph 8, were parties or privies to or knowingly assisted in, the formation and operation of a combination having or designed to have the effects of fixing common prices for corrugated paperboard shipping containers and parts, enhancing the prices thereof,

preventing or lessening competition in the production and sale thereof and substantially controlling their production and sale throughout Canada and in its several marketing districts, and otherwise restraining or injuring trade or commerce in these products. By virtue of the fact that the said corporations controlled virtually the entire production and sale at all relevant times, and because the combination had the effects specified, it has operated and is likely to operate to the detriment or against the interests of the public and therefore is a combine contrary to section 32 of the Combines Investigation Act.

6. It is further alleged that the said corporations and individual, during the periods mentioned, arranged among themselves to enhance unreasonably the prices of the said products, prevent or lessen competition unduly in the production and sale thereof, and otherwise restrain or injure trade or commerce in relation thereto, contrary to section 411 of the Criminal Code."

(Statement of Evidence, Paperboard
Shipping Containers and Related
Products, Vol. I, p.5)

Amendments to the Combines Investigation Act came into effect on August 10, 1960.⁽¹⁾ Prior to its amendment in 1960 the definition of a merger formed part of the definition of a "merger, trust or monopoly" and such a situation constituted an offence when the "merger, trust or monopoly" had operated or was likely to operate to the detriment or against the interest of the public. (Section 2). The amending Act of 1960, among other things, repealed the definitions of "combine" and "merger, trust or monopoly" in section 2 of the Combines Investigation Act and enacted new provisions in that section, including separate definitions of "merger" and of "monopoly". However, as control of Hendershot by C. I. P. was secured by February 10, 1960 the inquiry proceeded on the basis of the language in the Combines Investigation Act prior to its amendment in 1960.

(1)

An Act to Amend the Combines Investigation Act and the Criminal Code, S. C. 1960, c.45.

3. Description of Companies

Canadian International Paper Company (C. I. P.), which has its head office in Montreal, Quebec, is a wholly-owned subsidiary of International Paper Company. The latter is incorporated in the State of New York and has its executive offices in New York City. C. I. P. itself has several mills located in the province of Quebec, Ontario and New Brunswick. The company itself or its subsidiaries manufacture newsprint, sulphite and sulphate wood pulps, dissolving wood cellulose, kraft board and paper, fibreboards, hardboards, hardwood plywood, lumber, converted paper, and other products.

In late 1954, C. I. P. acquired from Brown Corporation certain properties including a kraft mill at La Tuque, Quebec. In March 1956 C. I. P. made its first shipment of kraft board from the La Tuque plant. In 1959, C. I. P. began to ship high-yield sulphite corrugating medium from its mills at Gatineau, Quebec and in 1960 from its mill at Hawkesbury, Ontario also.

C. I. P. had begun construction of a shipping container plant at Pointe aux Trembles (Montreal) sometime prior to May 1955. Before this plant was completed C. I. P. acquired Hygrade Containers Limited of London, Ontario, a manufacturer of shipping containers. Hygrade purchased the unfinished Pointe aux Trembles plant from C. I. P. in April 1956. In early 1960, C. I. P. completed transactions which gave it control of Hendershot.

Hendershot Paper Products Limited (Hendershot), had its head office in the City of Hamilton, Ontario. It was incorporated in March 1946 for the purpose of acquiring all the assets of the G. W. Hendershot Corrugated Paper Company Limited. The company sold its products through its own selling organization almost entirely in the Province of Ontario. In 1959 Hendershot was controlled by Mindustrial Corporation Ltd. During late 1959 and early 1960, C. I. P. completed certain business transactions, described below in this report, which resulted in its acquisition of Hendershot from Mindustrial Corporation Ltd. At the time of its acquisition by C. I. P., Hendershot was in possession of a new plant at Burlington, Ontario which had come into production in March 1958. Two older plants in Hamilton, Ontario had been sold in 1958 and 1959.

4. Conduct of the Inquiry

The Director's Statement of Evidence gives the following description of the evidence on which it is based:

" . . . "

2. The evidence obtained in the inquiry and upon which the Statement herein is based is:

- (a) All the evidence set out in the Statement of Evidence dated December 31, 1959, in the matter of an inquiry relating to the manufacture, distribution and sale of paperboard shipping containers and related products, copies of which have been sent to Canadian International Paper Company. This document is cited herein-after as 'the Shipping Containers Statement' and is incorporated herein by reference.
- (b) Documentary evidence obtained from Canadian International Paper Company and coded with the letters DTI and numerals 1 to 62. These have been stamped with serial numbers 1 to 61 inclusive, at the bottom right-hand corner of each document.
- (c) Documentary evidence obtained from Hendershot Paper Products Limited and coded with the letters DQC and the numerals 1 to 48 inclusive. These have been stamped with the serial numbers 62 to 126 inclusive, at the bottom right-hand corner of each document.

" . . . "

(Statement of Evidence, p.1)

The Commission, by an order dated May 3, 1960 fixed Monday, September 19, 1960 at ten o'clock in the forenoon as the date and time, and a courtroom of the Exchequer Court of Canada, Supreme Court Building, Wellington Street, Ottawa, as the place at which argument in support of the Statement of Evidence might be submitted by or on behalf of the Director and at which the persons against whom the allegations had been made in such Statement should be allowed full opportunity to be heard in person or by counsel. Subsequently, the date of the hearing was changed to November 28, 1960

to fit into the schedule of the Commission and to meet the convenience of counsel for C. I. P.

At the hearing, held on November 28, 1960 the following appearances were made:

Mr. F. C. Gascoigne)	For the Director of
Mr. F. N. MacLeod)	Investigation and Research
Mr. D. A. Rankin)	
Mr. John J. Robinette, Q.C.)	For Canadian International
Mr. Hazen Hansard, Q. C.)	Paper Company and
Mr. A. J. MacIntosh, Q. C.)	Hendershot Paper Products Limited

5. Position Taken by C. I. P. with Respect to the Director's Allegations

The Commission, in advance of the hearing, received from counsel for C. I. P. a written statement of the position taken with respect to the allegations made by the Director. This statement of position was supplemented by oral representations by counsel at the hearing. The points on which issue was taken in written and oral representations may be summarized as follows:

(1) Objection was taken to reliance by the Director on evidence obtained in the inquiry into the manufacture, distribution and sale of paperboard shipping containers and related products in support of allegations in the Statement of Evidence in the present inquiry. It was contended that the Director had no power to incorporate into the Statement of Evidence in the present inquiry evidence obtained in a separate inquiry.

(2) C. I. P.'s acquisition of Hendershot must be considered separately from the acquisition of Hygrade which was the subject of allegations in the Statement of Evidence in the inquiry relating to the manufacture, distribution and sale of paperboard shipping containers and related products.

(3) The acquisition of Hendershot involves such a trifling percentage of the market that it could not have any serious effect on competition. There was no acquisition of anything closely approximating monopoly power control. C. I. P. has not, by virtue of

this acquisition, acquired the power to dictate prices. There is no evidence to indicate that this was an acquisition for the purpose of getting rid of a competitor or of destroying competition.

(4) The acquisition of Hendershot was made for legitimate business reasons and in no way constituted an illegal merger or a merger, trust or monopoly within the meaning of the Combines Investigation Act. C. I. P. bought Hendershot because C. I. P. wanted an outlet for its increased board capacity. C. I. P., in supplying board to Hendershot, would have taken business away from St. Lawrence and Abitibi, which would have been competition.

(5) Whether C. I. P. paid too much or too little for Hendershot is a completely immaterial consideration.

(6) The Director's allegation that the price paid for the shares of Hendershot was too high is based on a price range which related to only one week in which only 240 shares of the total of 155,000 were sold in the market. Hendershot was in an unusual position at the time of the acquisition. Its earnings were low due to highly competitive conditions, the increased financial and operating costs of new facilities in Burlington, the interruption of services caused by the move and the initial start-up expenses at the new plant, plus the non-recurring expense of moving into the new premises and the continuing cost of maintaining unsold property then vacated. Because the company had had a very different experience in the past, there is little doubt that the management which controlled the company would have a very different view than the investor who sold his shares at \$4.80.

(7) There is no evidence presented by experienced people to show what would happen to the price of Hendershot shares on the market when an announcement was made of a desire to buy 85 per cent of that company's shares.

(8) If a comparison of purchase price with book value is to be made, the book value would have to be adjusted and real estate appraisals and other appraisals of that kind would have to be considered.

(9) The Director is unable to show that C. I. P. did not give full value for the said acquisition, the facts being to the contrary.

(10) There is no evidence of what the cost to C. I. P. would have been of buying a new plant and getting into business in Hamilton, and then fighting its way into the market as compared with the cost of buying a company with an established position. Goodwill is a factor that purchasers are willing to take into consideration.

(11) Thus the bases of value set out in the Statement of Evidence are not true measures of value in the circumstances.

(12) The acquisition in no way saddled the combined enterprise with unduly high overhead costs which in the final analysis would have to be borne by its customers and the general public.

(13) The Director is unable to show that the said acquisition has operated or is likely to operate to the detriment or against the interests of the public, the facts being to the contrary.

CHAPTER II

THE ACQUISITION OF HENDERSHOT BY C.I.P.

The events leading up to the acquisition of Hendershot by C. I. P. are described as follows in the Director's Statement:

" . . .

7. On December 23, 1959, a letter from P. A. Sargent, a Vice-President of C. I. P., to W. P. Walker, of Mindustrial Corporation Limited ('MINDUSTRIAL') set forth the gist of an agreement between these two companies in connection with the acquisition of HENDERSHOT, as follows:

'Pending finalization of the formal documents I am writing to confirm my understanding of the main points of agreement reached by us in connection with Hendershot Paper Products Limited.

1. We agree to buy, and you agree to sell, \$327,000 principal amount of General Mortgage 6-3/4% bonds of Hendershot Paper Products Limited at a price of \$85 per hundred dollar par value of bonds. This transaction is to be irrevocable irrespective of the outcome of the remaining portion of the arrangement detailed below.

2. Upon completion at the earliest possible date of the necessary work we agree to make a public offer to buy the outstanding shares of common stock and warrants to purchase common stock of Hendershot contingent upon sufficient shares and warrants being so acquired by us to assure us ownership of at least 85% of the aggregate number of common shares now outstanding and those which would be outstanding if all the warrants were exercised. This offer is to be made for a 45 day period and will provide that we reserve the right to terminate it when the above-mentioned 85% is obtained. The price payable to you will be \$9.00 per common share and \$2.00 per purchase warrant. The price for all common shares will be \$9.00 but at your suggestion the price for the publicly

held purchase warrants has been increased to and will be \$3.00 per warrant with a view to encouraging public acceptance of the offer. Your company agrees to sell to us not less than 88,190 common shares and not less than 39,810 purchase warrants at the above prices \$9.00 and \$2.00 respectively. At the end of the aforementioned 45 day initial period either of us can extend the time of the offer to 90 days at the end of which it will expire.

3. You agree that both Mindustrial and Hendershot will assist us in the preparation of any logical statement, including a letter of recommendation over the signature of the appropriate senior officer of Hendershot with the approval of its board, to accompany the offer which will help to assure the deposit of the maximum number of shares and warrants.

4. In the event that we do secure the 85% ownership as provided above you agree:

A. That the management agreement between Hochelaga Investments Limited and Hendershot will be cancelled at our request on thirty days notice.

B. To secure for us, if requested, the resignation of all or any of the Directors of Hendershot.

5. From now until the expiration of the offer you agree that the business of Hendershot will be carried on in the usual and ordinary course as heretofore; that no dividends will be declared or paid and that no long term commitments will be entered into.

6. We both agree to do all possible to ensure that the names of neither Canadian International Paper Company nor Hygrade Containers Limited become associated with this offer, it being understood that the public offer will be made in the name of Canada Permanent Trust Company or such other trust company as we may select.

7. You agree to take the necessary steps to cancel the supply contract which Hendershot has with St. Lawrence Paper Corporation so that it will terminate on December 31, 1961. In the event that we do not secure the aforesaid 85% ownership we agree to make

available to Hendershot on terms and at prices mutually satisfactory any kraft container board required by it after January 1, 1960, due to the cancellation of the St. Lawrence contract.

The formal agreement between us, including the public offer, will contain the usual representations, warranties, terms and conditions, all as may be mutually agreed upon.

For your information it is our intention that this deal will be taken in the name of our wholly-owned subsidiary, Hygrade Containers Limited.

(Serials 9-11)'

. . . "

(Statement of Evidence, pp.2-3)

An agreement in the form of a letter from Canada Permanent Trust Company to Mindustrial Corporation Limited, dated January 7, 1960, confirmed on the same day by Mindustrial Corporation Limited, was entered into, incorporating all the necessary arrangements and safeguards, necessary to carry out the intent of the letter quoted above (Serials 31-57).

Paragraph 7 of the Statement of Evidence continues as follows:

". . . By February 2, 1960, the Canada Permanent Trust Company had purchased on behalf of C. I. P., a total of 52, 985 shares and 17, 855 share warrants. Together with those obtained from MINDUSTRIAL, C. I. P. now had the following holdings:

	<u>Shares</u>	<u>Share Warrants</u>
From Public	52, 985	17, 855
From Mindustrial	89, 190	39, 810
	142, 175	57, 665 (Serial 13)

The common shares of HENDERSHOT outstanding totalled 155, 945 and share warrants totalled 64, 095 (Serials 6-7). On February 10, 1960 a circular letter was sent out by HENDER-SHOT announcing the acquisition by C. I. P. of 'the majority of the common shares of our Company' (Serial 62) and the Director was informed verbally by C. I. P., at about the same time, that it now had 93.51 per cent of the shares.

. . . "

(Statement of Evidence, p.3)

Although the Director's Statement of Evidence says that there were share warrants for 64,095 shares outstanding, the documentary evidence indicates a slightly larger number. Serial 6, which is the balance sheet of Hendershot Paper Products Limited at November 30, 1959 records:

"(1) At November 30, 1959 share warrants were outstanding carrying the right to purchase 64,095 common shares -

At \$ 7 per share to August 31, 1961

At \$10 per share to August 31, 1962

During the eleven months ended November 30, 1959, 240 warrants were exercised and 170 warrants were cancelled."

(Serial 6)

On the other hand, Serials 34 and 60 mention a figure of 64,265. Serial 34, which is part of the letter from the Canada Permanent Trust Company to Mindustrial Corporation Ltd., of January 7, 1960 says in part:

". . . and there shall be outstanding warrants for the purchase of no more than 64,265 common shares without par value at the price of \$7.00 per share until August 31, 1961, and at the price of \$10.00 per share thereafter and until their expiry date, August 31, 1962;
. . ."

(Serial 34)

Serial 60, which is one of a group of four serials (Serials 58-61) which comprise an assessment of the Hendershot Company for the purposes of acquisition, refers to 64,265 as being the number of total outstanding common share warrants. This group of documents was dated December 22, 1959. Serial 20, which again is part of a group of documents (Serials 16-30) which comprise an assessment of the Hendershot Paper Products Limited dated December 16, 1959 again refers to 64,265 as being the total number of shares for which warrants to purchase had been issued. The difference between the two figures, 64,095 and 64,265, is 170, and is no doubt accounted for by the statement in Serial 6 that 170 warrants were cancelled in 1959.

The Director's Statement of Evidence continues:

" . . .

8. Financial reports of HENDERSHOT are in evidence as follows:

Year ended December 31, 1955	-	Serials	87	to	90
" " " 31, 1956	-	"	91	"	95
" " " 31, 1957	-	"	96	"	100
" " " 31, 1958	-	"	101	"	107
Eleven months ended November 30, 1959	-	"	5	"	8

During the three years December 31, 1953-5 inclusive HENDER-SHOT, operating from its old Hamilton plant, was very successful. Its 5 per cent dividends on the cumulative preference stock, being \$12,500 per year, were duly paid, and regular dividends totalling \$37,500 annually were paid on its common stock, which was 30,000 N.P.V. shares issued at \$30,000. During the same period the balance of its Earned Surplus account increased from about \$156,000 at the end of 1953 to \$353,000 at the end of 1955. During 1956, business continued to be very favourable. After June 1956 an additional \$450,000 in preferred shares was added to the company's capital and over \$211,000 new capital was subscribed for 35,214 new N.P.V. common shares. The former 30,000 N.P.V. shares were subdivided 4 to 1. During the year preferred dividends totalling \$26,900 and common dividends totalling \$48,264 were paid, and the balance of Earned Surplus further increased to about \$384,000, an addition of about \$31,000 for the year. The President's report to the Shareholders for 1956 included the statement that expansion of plant facilities would be necessary in the near future and that a site had been acquired during the year in Nelson Township (now the Town of Burlington), where it was proposed to erect a modern plant which would house necessary facilities and provide ample room for expansion. During 1957, the decision was taken to dispose of the Hamilton properties, to proceed with the building plans and to install additional high speed equipment to supplement that already owned by the company. By the end of the year the new building at Burlington was completed and a partial operation was underway, while production continued at Hamilton. In order to finance this expansion programme two issues of Mortgage Sinking Fund Bonds were sold, the first having a face value of \$1,000,000, paying $6\frac{1}{2}$ per cent, and the second a face value of \$500,000, paying $6\frac{3}{4}$ per cent. For 1957, operations were again profitable and \$157,000 were transferred to Earned Surplus, from which the 6 per cent dividend on preference stock was declared, amounting to \$42,000, and common dividends were \$62,122.70. During the year 1958, the company suffered a substantial loss. No common dividends were paid after July 2, 1958, and regular preference

dividends had to be paid out of earned surplus, which declined to \$242, 000 at the end of 1958. The following are extracts from the President's Report to the Shareholders for 1958:

'Earnings

Earnings before depreciation and bond interest were at the unusually low figure of \$29, 000 in 1958. This compares with \$208, 000 in the prior year. After depreciation of \$117, 000 and bond interest and amortization expense of \$83, 000, there was a loss from operations of \$171, 000, which was reduced to \$104, 000 by application of profit realized on disposal of fixed assets. No income tax has been provided.

The chief reasons for the considerably lower net operating results are:

The highly competitive conditions prevailing in the industry which not only retarded expansion of sales but also saw a further narrowing of profit margins as increased costs were not offset by price adjustments.

The increased financial and operating costs of our new and enlarged facilities at Burlington.

The interruption to services caused by the move and the initial start-up expenses at the new plant. The non-recurring expense of moving into the new premises.

The continuing cost of maintaining unsold property then vacated.

Moving from the Hamilton premises commenced at the turn of the year and by early spring this was essentially completed. During this period partial operations were carried out in each set of premises with consequent excess labour and material usage, including some due to processing raw materials purchased prior to the start-up of the new large-capacity corrugator. As the year progressed, efficiency improved and, coupled with a strengthening economy, sales showed modest growth. The fourth quarter billings exceeded by 13% those of the comparable quarter in 1957.

Fixed Assets and Working Capital

During the year virtually all planned capital expenditures for buildings, plant and equipment were completed. Hendershot facilities, which are of the finest, are now housed in excellent premises,

centrally located in the heart of industrial Canada. There is no other plant in the country better equipped or located to supply the market.

One of the Hamilton properties was disposed of during 1958 and it is anticipated that the remaining plant will be sold in the near future. All securities of the company which were created to finance the expense of the new plant have been sold in accordance with the terms contemplated.

• • •

Outlook

The outlook for the company in both the short and particularly the long term is considered highly favourable. Our productive capacity has been greatly increased and the efficiency of the plant is good. A development during the year of highly favourable significance was the acquisition of an exclusive Canadian license to use the patents and know-how of the 'Control-Pak' system. By this system the company is able to produce a type of container which is essentially waterimpervious and of substantially increased strength. Many uses for this container are apparent and interest has been widespread in the produce, dairy, fish and meat-packing industries. Although commercial production has only recently commenced your directors are already most enthusiastic as to the variety of applications and volume of business which await Control-Pak products.

Your company's operations are now based in completely modern facilities which are strategically located and are capable of a large expansion of output. Hendershot is proud of its reputation for service and for the quality of its products. These factors together with the opportunities open to us for the manufacture of Control-Pak containers, indicate that we should all view the future with considerable optimism.'

(Serial 103)

The financial results of the company in the eleven months ended November 30, 1959, continued to be unfavourable. Arrears of dividends on the cumulative preference shares amounted to \$31,500, no common dividends were paid, and the earned surplus declined from \$242,000 to \$78,000. In a circular letter to the

Shareholders, the Chairman of the Board of HENDERSHOT, on January 11, 1960, commented upon these results, in part as follows:

'To assist your evaluation of the offer now in your hands, audited figures of operations for the 11 months ending November 30, 1959, and the balance sheet as of that date are enclosed together with the comparative figures for the full year ended December 31, 1958.

During the years 1957 and 1958 your company built and equipped modern premises, favourably situated at Burlington, and then disposed of its former premises in nearby Hamilton. This has permitted, and indeed made necessary, a major growth in sales which is being achieved more slowly than was anticipated. Competition has increased and costs have risen without fully compensating price improvement. The company anticipates that, with its modern, strategically located plant and with acceptable products, its sales and operating results will improve materially in future years. However, as shown by the financial statements operations have been unprofitable since the move to new premises in 1958 and therefore it is likely to be some time before earnings will permit payment of arrears on Preference shares and the payment of significant Common dividends.

Having regard to the foregoing considerations your directors believe that the offer which has been made should be accepted. Consequently, each director will tender any shares or warrants held by him. Mindustrial Corporation Limited, the holder of a majority of all outstanding Common shares and warrants has agreed to tender its entire holdings at the price of \$9.00 per Common share and a price of \$2.00 per warrant.'

(Serial 5)

9. Since HENDERSHOT had disposed of its Hamilton properties and had acquired all but a small part of its machinery and equipment at current prices, it is clear that the fixed assets of the company were not substantially undervalued in its financial statements for the period ended November 30, 1959. Most other assets were valued at current prices and there were no apparent hidden reserves, except to the extent that depreciation charges might overstate the loss in value of the new plant. No precise valuation could be placed on

the asset entitled patents, trade names and contracts, carried at \$45,000, but conservative accounting practice is to write such an asset off as soon as practicable. Accordingly, the book net worth can be taken as a fairly accurate statement of the actual net worth of the company as of the date of the financial statement on November 30, 1959, except to the extent that goodwill, not valued by the company in its accounts, had real value to a purchaser. Apart from this consideration, however, the financial statement showed that the equity of the common stock in the company's assets as of November 30, 1959, was as follows:

Capital plus Earned Surplus	\$1,023,081
Less Preferred Shares at call value of \$105	735,000
Less Preferred dividends in arrears	<u>31,500</u>
Total Equity	<u>\$ 256,581</u>

For this equity, the price to be paid by C. I. P. totalled \$1,555,980, calculated as follows:

155,945 shares at \$9	\$1,403,505
Warrants held by Mindustrial 39,810 at \$2	79,620
Warrants held by others 24,285 at \$3	<u>72,855</u>
	\$1,555,980
	<u><u></u></u>

The purchase price was therefore more than six times the book value of the equity acquired by C. I. P. "

(Statement of Evidence, pp.3-6)

Although the Director has calculated the price to be paid by C. I. P. on the basis of the total number of outstanding shares and outstanding warrants to purchase shares, there is no evidence that C. I. P. in fact did acquire the whole of the outstanding shares or outstanding warrants. Serial 13, quoted earlier in this report, shows that on February 2, 1960, C. I. P. had 142,175 shares and warrants for 57,665 shares. Further, evidence referred to by the Director in paragraph 7 of the Statement of Evidence (quoted earlier in this report) is to the effect that C. I. P. had not purchased all of the shares and warrants by February 10, 1960. Again, Serial 60 refers to there having been warrants to purchase 24,455 common shares in the hands of other persons than Mindustrial. Furthermore,

The Financial Post Survey of Industrials, 1961, page 265 says:

"Purchase Offer - In Jan., 1960, Canadian International Paper Co. offered to purchase all o/s com. shs. at \$9, and warrants at \$3. All but 552 com. shs. and warrants for 2,280 shs. had been acquired when offer expired. No continuing offer made."

The Statement of Evidence continues as follows:

"10. As reported in the Financial Post, the 1959 range of prices for HENDERSHOT common was from \$4.00 to \$5.12½ per share, and in the week ending December 18, 1959, 120 shares were traded at a price of \$4.75. The cost of exchanging the share warrants for shares exceeded the stock market price throughout most of the year, although during the eleven months 240 such warrants were exercised. As indicated above, the price per share paid by C. I. P. was \$9.00, and the price paid for each share warrant was \$3.00 to the public and \$2.00 to MINDUSTRIAL, at a time when it would have cost the holders of such share warrants \$7.00 per share to exercise their rights to purchase shares valued by the market at \$4.75."

(Statement of Evidence, p.6)

On the other hand, The Financial Post Survey of Industrials, 1960, page 43, shows that Hendershot Paper's new shares of no par value sold at a high of \$8.25 and a low of \$4.00 during 1959. Serial 5, which is a letter from Hendershot Paper Products Limited to the shareholders of January 11, 1960, makes reference to the company's shares having been sold in ". . . a price range of \$4.00 to \$5.50 per share in 1959 prior to intimation of this offer" (Serial 5). Hendershot Paper Products' balance sheet of November 30, 1959 (Serial 47) shows that during 1959, 240 shares were issued for cash \$1,200. This would indicate issue at an average price of \$5.00 per share.

The Statement of Evidence continues as follows:

"11. The documents of C. I. P. indicate that the acquisition was made for the following reasons:

- a) C. I. P. would require more capacity in south central Ontario in 1962, and as their Toronto converting plant was not equipped for such an expansion, acquisition of HENDERSHOT would relieve the company of undertaking an expansion programme (Serials 1-2).

- b) In 1962 and subsequent years C. I. P. would supply substantial tonnage of containerboard to HENDER-SHOT from its existing facilities at La Tuque, in place of St. Lawrence Corporation Limited and Abitibi Sales Company Limited with whom HENDER-SHOT presently had supply contracts. The resultant earnings to C. I. P. would yield a substantial return on its investment in HENDERSHOT (Serials 60-61)."

(Statement of Evidence, pp.6-7)

There is evidence that C. I. P. considered the acquisition of Hendershot to be a desirable alternative to building a new plant in south central Ontario. A document entitled "HENDERSHOT PAPER" signed by P. A. S. (P. A. Sargent, a Vice-President of C. I. P.) and dated December 31, 1959, contained the following:

"3. By securing Mindustrial holdings and control of company we would be in a position to:

A. Immediately save:

Balance of projected work on Toronto plant	\$300,000
Elimination of waxing equipment	28,000
	<hr/>
	\$328,000

. . .

C. In 1962 be relieved [sic] of necessity of putting up a new plant in this area:

Estimated cost of plant	\$2,750,000
Working capital required	500,000
Saving of start-up losses of new competitive plant based on	
Montreal and Toronto	375,000
	<hr/>
	\$3,625,000

(Serials 1-2)

The document contains several estimates of the possible cost of securing control of Hendershot and also the additional cost of acquiring complete ownership. With respect to the various estimates of these costs the document says:

"6. Thus for one of the totals in 4 plus total of 5 we would have secured following tangible assets:

Land	\$ 225,000
Building (1960 Replacement cost)	1,565,000
Equipment	1,300,000
6 Tractor-trailer rigs	25,000
Working capital (Dec. 31, 1959)	<u>225,000</u>
	\$3,340,000

January 1, 1960 order book position of 9,300 tons per year."

(Serial 2)

Further evidence that purchase of control was considered to be a desirable alternative to construction is found in an unsigned report on "H COMPANY", dated December 22, 1959 (Serials 59-62) which contains the following:

"Over the next two years (1960 and 1961) the Company is expected to about break even in net earnings. Therefore no return on investment can be expected until 1962 when La Tuque will begin to supply the tonnage. Under a construction program there would also be a period of non-monetary return investment. Such investment would average about \$1,200,000 - \$1,400,000 until the beginning of 1962".

(Serial 62)

CHAPTER III

CONSIDERATION OF THE ALLEGATIONS OF THE DIRECTOR

The Director has alleged that the price paid by C. I. P. for Hendershot was excessive on the ground that it was much larger than the book value of the equity acquired by C. I. P. The Director has defined this equity as Hendershot's capital plus earned surplus less the call value of its outstanding preferred shares and the arrears of dividends on them. This might be taken as a measure of the cumulative historical investment in the enterprise by the common shareholders.

The equity so defined is not necessarily a measure of the value of the company. The value of an enterprise is related to its present and future ability to earn profits directly or indirectly, and this may bear no relationship whatsoever to the amount of money invested in it. As a generalization, it can be said that a company's ability to earn may be influenced by many things such as the quality of its management, product innovation, changes in costs of materials in relation to prices of finished products, technological changes, the effectiveness of its marketing function, etc., which may be quite independent of its shareholders' equity. In the present case, while Hendershot had made losses during the previous two years, C. I. P. believed that Hendershot might break even in 1960 and 1961, but that in 1962 a return on investment could be expected when La Tuque began to supply Hendershot's containerboard requirements. C. I. P. estimated this would result in an increase in net earnings at La Tuque of a size to justify paying a price of \$2 million or more to acquire Hendershot (Serials 60-61).

The evidence clearly shows that in the opinion of C. I. P. the acquisition of Hendershot would save the company a great deal of money that would otherwise have had to be invested in a new plant and in the extension of the existing Hygrade plant to provide an increased outlet for the containerboard produced at La Tuque. The savings which

were envisaged from this alone greatly exceeded the price paid by C. I. P. In addition, C. I. P. acquired a going concern having an established sales volume. There would undoubtedly also be savings to be made by the acquisition through the avoidance of the start-up costs of a new plant and the losses arising out of the need to build added sales volume in competition with other shipping container firms. The value which C. I. P. placed on the land, buildings, equipment, trucks, and working capital which it would acquire as a result of the acquisition was much higher than the price C. I. P. paid (Serial 2).

The Director's comparison of the price of \$9.00 per share paid by C. I. P. for over 90 per cent of the 155,945 issued shares of Hendershot with the price paid in one week of December 1959 for a mere 240 shares does not prove that the \$9.00 figure is excessive. The announcement by Canada Permanent Trust Company that an undisclosed principal sought to buy all the outstanding common shares and common share warrants of Hendershot would make it inevitable that the price of the shares would have to be above \$4.75. There is, moreover, evidence cited in the previous chapter, that during 1959 Hendershot shares had sold for as high as \$8.25.

On the basis of the evidence the Commission considers the allegation of an excessive price paid by C. I. P. for Hendershot is not proven. The evidence indicates that C. I. P. paid a price which it considered, on the basis of future earnings either direct or indirect, would secure a reasonable return to the company on its investment. In the circumstances this appears to the Commission to be a valid basis for the appraisal of the value of the acquisition.

In 1959, Hendershot produced 2.57 per cent of the output of all shipping container plants in the provinces of Ontario and Quebec. It was, therefore, among the smaller producers, only two other manufacturers in the two provinces having smaller production. The plants of C. I. P.'s subsidiary, Hygrade Containers Limited, had an output in 1959 equivalent to 15.06 per cent of the total production of shipping containers in the provinces of Ontario and Quebec. In 1960, the production of Hendershot accounted for 2.80 per cent of the output of all Ontario and Quebec plants while that of the Hygrade plants amounted to 15.65 per cent. Thus the production of shipping containers under the control of C. I. P. in Ontario and Quebec increased from 15.06 per cent (Hygrade) in 1959 to 18.45 per cent (Hygrade and Hendershot) in 1960. While the acquisition of Hendershot did not add a great deal to the proportion of the total production of shipping containers under the control of C. I. P. it increased its rank as the third largest producer in Ontario and Quebec significantly and brought its position considerably closer to that of the second largest producer. The change in the general position was that the four largest producers, all integrated companies, who accounted for 74.34 per cent of the total output of shipping containers in Ontario and Quebec in 1959 accounted

for 77 per cent in 1960.

The acquisition of Hendershot did not provide immediately an enlarged market for board from C. I. P., presumably because of the supply arrangements Hendershot had with other companies which, as shown earlier, were to continue in one instance until the end of 1961. C. I. P. was able to increase its shipments in 1960 to other users so that its share of all containerboard shipped into Ontario and Quebec increased to 21.09 per cent in 1960 compared with 19.52 per cent in 1959. An increasing proportion of C. I. P.'s shipments went to its own converting plants, the percentage advancing from 64.76 per cent in 1959 to 71.10 per cent in 1960.

Although the acquisition of Hendershot did not make an immediate contribution to C. I. P.'s increased share of the containerboard market it can be expected, assuming that Hendershot maintains its share of the production of shipping containers in the central provinces in the years following 1960, that a further strengthening of C. I. P.'s position in the containerboard market is likely to occur when it becomes Hendershot's principal supplier of board.

The report of the Commission on the inquiry into the shipping container industry describes in detail the pricing practices which have been employed by the industry members in the post-war period. As shown in that report, the structure of prices was based upon a manual of pricing components prepared by Mr. F. C. Hayes, President of Container Statistics Limited, with uniform mark-ups applying within designated pricing regions. Except for one container manufacturer who started operations toward the end of the period covered by the inquiry all companies were associated either with Container Statistics Limited or Mr. F. C. Hayes. In addition to the Container Statistics manual, price lists were in use for such products as beer cartons, cannery cartons and single-faced corrugated rolls.

Although Hendershot was among the companies associated with Container Statistics Limited and used the manual and the common mark-up applying in the Ontario - Quebec region in pricing its products, a substantial part of its business was sold subject to discounts from the price levels established by the Container Statistics system of pricing. The nature and extent of Hendershot's departures from the manual system of pricing are described in the Commission's report on the shipping container industry. C. I. P.'s

subsidiary, Hygrade, also gave discounts in connection with some sales but its departures from the price levels established by the manual system of pricing do not appear to have been as extensive as in the case of Hendershot. At one time it appears that for one group of customers Hygrade and Hendershot were competing for business by granting discounts.

In the opinion of the Commission the placing of Hendershot and Hygrade under the control of the same owner would be bound to affect the competitive relationship of the two firms and thus the competitive relationship of Hendershot with other shipping container manufacturers. There is no evidence before the Commission that the removal of Hendershot as a competitor of Hygrade was a motive leading C. I. P. to acquire Hendershot but the power to achieve this result was an inevitable outcome of the acquisition.

CHAPTER IV

CONCLUSIONS

The acquisition of Hendershot by C. I. P. reduced from 5 to 4 the number of non-integrated manufacturers of shipping containers in Ontario - Quebec in 1960, and two of these four, viz., Dominion Containers and Champlain, may be regarded as one entity, since Champlain is controlled by Dominion Containers. It was one of a series of acquisitions of shipping container firms by board mills which, by 1960, resulted in more than 85 per cent of the production of shipping containers in Ontario - Quebec being produced by integrated board-container companies and 77 per cent by four groups of such firms. The consequences of this development in limiting the opportunities for new entrants into either the board or container fields are examined at some length in the Commission's report on the shipping container industry and while these considerations are not repeated here they are relevant in the present inquiry.

Although Hendershot occupied only a small part in the shipping container industry in Ontario - Quebec it appears to have acted competitively in some segments of its business even while using the manual system of pricing which was employed by other container firms. Its acquisition by C. I. P. makes unlikely the continuance of practices by Hendershot which would differ from those employed by Hygrade.

In the Commission's report on the shipping container industry the Commission expressed the fear that even if the common pricing arrangements which existed in the industry over such a lengthy period were abandoned the high degree of concentration which now exists in the shipping container industry would make possible the maintenance of common prices without the necessity of any formal arrangements. Each disappearance of an independent shipping container manufacturer adds to the degree of concentration in greater or less degree depending upon its size.

In view of Hendershot's small share of the Ontario - Quebec market for containers (2.57 per cent in 1959 and 2.80 per cent in 1960) and the fact that C. I. P.'s share of that market in 1960 (including Hendershot's production) only reached 18.45 per cent, no one would suggest that as a result of the merger C. I. P. was in a position to carry on its container business virtually free from the influence of competition. This conclusion would not be altered even if the acquisition of Hendershot were considered in conjunction with the earlier acquisition of Hygrade, instead of as an entirely separate matter under the Combines Investigation Act. On the basis, therefore, of the judicial reasoning in the Canadian Breweries and Sugar cases the Commission's opinion is that the acquisition of Hendershot would not be held to constitute an offence.

For similar and other reasons which are set out fully in the shipping container report the Commission concluded that dissolution of mergers could not be used under the Combines Investigation Act, as it has been interpreted by the Courts, to restore competitive conditions to the shipping container industry. The Commission recommended certain tariff changes which it considered would protect the public from unnecessarily high prices of containerboard and shipping containers and which would assist in removing the restrictive effects on the supply of containerboard which are inherent in the situation where a predominant part of the containerboard production in Canada is made by integrated companies and is used in their own converting operations. The Commission considers that its recommendations in the inquiry relating to shipping containers are relevant in the present inquiry.

(Sgd.) C. R. Smith

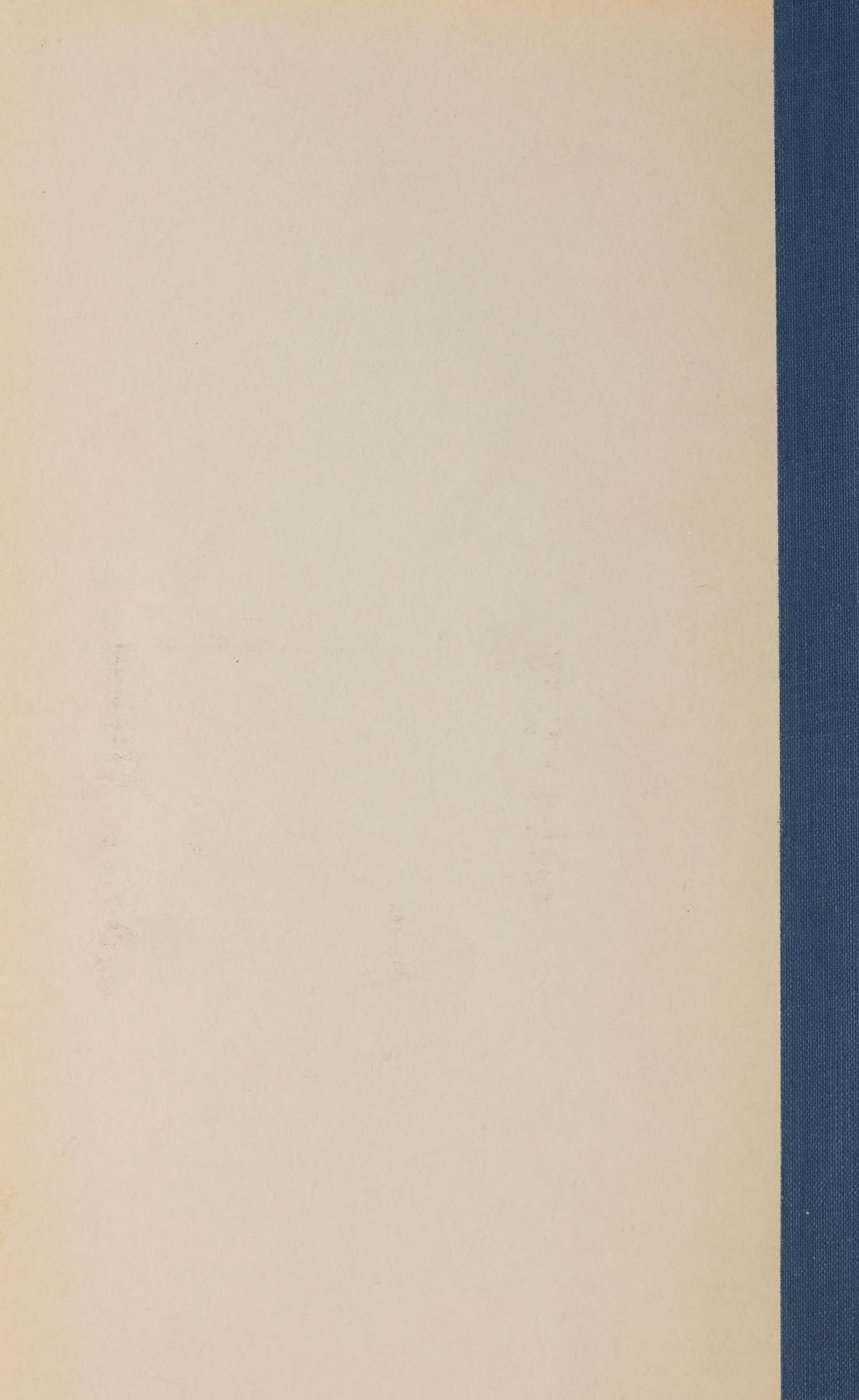
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